

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:NR:DAL:2OKLPOSTF-121097-02
EFMoates

date: **MAY 16 2002**

to: [REDACTED], Manager LMSB, [REDACTED]

attn: Pat Patterson, Revenue Agent, Dallas, Texas

from: Associate Area Counsel

subject: [REDACTED] Inc. and Subsidiaries - NOL carry forward

We are responding to your request for guidance on whether corporate owned life insurance (COLI) adjustments to correctly compute the net operating loss (NOL) carry forward may be made after the above referenced case was closed by Appeals via a Form 870-AD. After consideration of all the facts and circumstances we have concluded that adjustments should be made in calculating the correct [REDACTED] NOL carry forward to be carried to later years.

Although we informally coordinated this matter with the National Office, the advisory is subject to the review procedures of CCDM (35)3(19)4(4). The CCDM procedures require us to transmit a copy of the memorandum to the National Office. The National Office has ten days from receipt of our memorandum to respond. The National Office may extend the review period if necessary. We will keep you informed of any delays.

FACTS

[REDACTED] Inc. and Subsidiaries ([REDACTED]) was examined for the taxable years [REDACTED] through [REDACTED]. No COLI adjustments were examined for the taxable years [REDACTED] through [REDACTED].

The [REDACTED] case was ultimately settled by Appeals and a Form 870-AD was executed by the taxpayer and was approved by the Joint Committee on [REDACTED]. The Form 870-AD was executed for the government on [REDACTED]. The Form 870-AD reflected the following deficiencies and/or (overassessments):

YEAR ENDED

KIND OF TAX

TAX

[REDACTED]
[REDACTED]
[REDACTED]

Income
Income
Income

([REDACTED])
([REDACTED])
[REDACTED]

Income
Income
Income

Appeals allowed the net operating loss to be carried back to and . Per the appeals officer the unused NOL carried forward from is \$.

When the agent started the examination of the current cycle (through) she discovered COLI adjustments relating to the and taxable years. The Revenue Agent has proposed adjusting the taxable income and NOL by COLI adjustments of \$ and \$, respectively.¹ After these adjustments the unused NOL carry forward is, \$. The first year the unused NOL carry forward could be used by the taxpayer is . See comments below concerning the and returns and pending adjustments.

's return reflects a \$ NOL. filed a tentative (Form 1139) and carried back \$ to the taxable year. The Revenue Agent's report has a adjustment pending of \$. After the proposed adjustment the NOL available for carry forward is \$.

's return reflects a \$ NOL. The Revenue Agents's report has a adjustment pending of \$. The NOL carry forward (after the and COLI adjustments) available to be applied to the return is \$. The NOL available to be applied to the return is \$. After application of the NOL carry forward as corrected and the NOL carry forward the return would have taxable income of \$.

¹ The ability to make the COLI adjustments to correctly compute the NOL carry forward after executing a Form 870-AD for the year is presently at issue.

Discussion

At issue in this case is whether the government can make adjustments to determine the correct NOL carry forward after entering into a Form 870-AD with the taxpayer. The Form 870-AD executed in this case contains the following language:

... If offer is accepted, the case will not be reopened by the Commissioner unless there was:

- . fraud, malfeasance, concealment or misrepresentation of a material fact
- . an important mistake in mathematical calculation
- . a deficiency or overassessment resulting from adjustments made under Subchapters C and D or Chapter 63 concerning the tax treatment of partnership and subchapter S items determined at the partnership and corporate level
- . an excessive tentative allowance of a carryback provided by law.

In this instance the taxpayer carried the [REDACTED] NOL back to [REDACTED] instead of [REDACTED].² If the [REDACTED] NOL had been carried back to [REDACTED], it is clear that an COLI adjustment could be made to decrease the amount of the [REDACTED] NOL carry forward if any. However, no tax deficiency could be established for the [REDACTED] taxable year.

Relying on the plain language of the Form 870-AD, the question remains as to whether adjustments to establish the correct amount of the NOL carry forward is a "reopening". There appears to be no authority directly on point on this issue. The adjustments proposed by the Service would entail reducing a net operating loss previously allowed ([REDACTED]) and increasing taxable income for [REDACTED] which would increase the application of the NOL carry forward, further decreasing the NOL carry forward deductions. Thus, the Service does not desire to make any additional assessments, but instead reduce a NOL carry forward deduction.

In the case of Lewis v. Reynolds, 284 U.S. 281 (1932), the Supreme Court made it clear that a taxpayer is not entitled to a refund unless the taxpayer has in fact overpaid the tax. The Supreme Court went on to hold that in determining whether a

²I.R.C. § 172(b)(1)(A)(i) changed the carryback period from three years to two years for taxable years beginning after 8/5/97.

taxpayer has overpaid taxes, it is proper for the Service to redetermine the taxpayer's entire liability, even though the applicable statute of limitations bars the assessment and collection of any additional tax. Lewis v. Reynolds, 284 U.S. 281, 284 (1932). See also Rev. Rul. 85-67, 1985-1 C.B. 364 and Rev. Rul. 81-87, 1981 C.B. 580. Furthermore, several courts have held that taxable income for purposes of the net operating loss deduction permitted by I.R.C. § 172(b)(2) means correct taxable income. Springfield Street Railway Co. v. United States, 312 F.2d 754 (Ct. Cl. 1963); Pacific Transport Co. v. United States, 483 F.2d 215 (9th Cir. 1973); Phoenix Coal Co. v. Commissioner, 231 F.2d 420 (2nd Cir. 1956).

Applying the above-cited authority to the case at hand, in order to determine the correct taxable income for any future year in which the NOL carry forward deduction may be utilized, the Service may recalculate or adjust [REDACTED]'s [REDACTED] NOL carry forward. In performing this recalculation, the Service may make adjustments which reduce or eliminate the claimed refunds without regard to the expired statute of limitations or the Form 870-AD waiver. However, this recalculation of the NOL carry forward can only be used to reduce or eliminate any claimed refund, no additional assessments can be made for [REDACTED]'s [REDACTED] or [REDACTED] taxable years.

It should be noted that pursuant to I.R.C. § 6214(b) [REDACTED] has recourse to raise this issue before the Tax Court. I.R.C. § 6214(b) states:

The Tax Court in redetermining a deficiency of income tax for any taxable year ... shall consider such facts with relation to the taxes for other years ... as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other year ... has been overpaid or underpaid.

Thus, in the taxable year that [REDACTED] has net taxable income after all adjustments, it may petition the Tax Court raising as an issue the reduction of the NOL carry forward due to the COLI adjustments in [REDACTED] and [REDACTED].

CONCLUSION

Adjustments may be made in calculating the correct [REDACTED] NOL carry forward to be carried to later years.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse

effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions, please contact Attorney Edith F. Moates at (405) 297-4832.

MARK A. O'LEARY (Group 2)
Associate Area Counsel

By: _____
EDITH F. MOATES
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